

## Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01  
INR-10 NSAE-00 ICA-20 TRSE-00 XMB-04 OPIC-06  
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R 012020Z AUG 78  
FM AMEMBASSY BRASILIA  
TO SECSTATE WASHDC 8489  
INFO AMCONSUL RIO DE JANEIRO  
AMCONSUL SAO PAULO

UNCLAS BRASILIA 6018

E.O. 11652: N/A  
TAGS: EFIN, BR  
SUBJECT: CENTRAL BANK IMPOSES ADDITIONAL MONETARY RESTRAINTS

REF: A) 77 BRASILIA 8721, B) BRASILIA 4921, C) BRASILIA 5591

1. SUMMARY - EFFECTIVE 31 JULY CENTRAL BANK RAISED REDISCOUNT RATES FOR BORROWING BY FINANCIAL INSTITUTIONS. DURING LAST WEEK OF JULY MONETARY AUTHORITIES ALSO PERMITTED INCREASE IN YIELD ON TREASURY BILLS IN OPEN MARKET IN MOVE TO CONTRACT LIQUIDITY. LATEST MEASURES TO CONTROL EXCESSIVE MONETARY EXPANSION WERE PROMPTED BY LARGE-SCALE RECOURSE TO CENTRAL BANK REDISCOUNTS AND CONTINUED COMMERCIAL BANK LENDING ABOVE MONETARY BUDGET PROJECTIONS. END SUMMARY.

2. IN A FURTHER MOVE TO RESTRAIN MONETARY GROWTH, THE CENTRAL BANK INCREASED REDISCOUNT RATES FOR THE FIRST TIME SINCE OCTOBER 1977 (REF A). EFFECTIVE 31 JULY 1978 COMMERCIAL BANKS WILL PAY 33 PERCENT P.A. FOR BORROWING FROM THE CENTRAL BANK UP TO THE EQUIVALENT OF 6 PERCENT OF AVERAGE END OF MONTH DEPOSITS DURING THE PERIOD  
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AUG-NOV 1977. FOR FUNDS FROM THE CENTRAL BANK IN EXCESS OF THAT LIMIT COMMERCIAL BANKS WILL PAY 36 PERCENT P.A. THE PREVIOUS CHARGES WERE, RESPECTIVELY, 30 PERCENT AND 32 PERCENT.

3. THE INCREASES IN REDISCOUNT RATES FOR INVESTMENT BANKS AND FINANCEIRAS WERE LARGER, FROM 40 PERCENT TO

49 PERCENT ON BORROWING WITHIN NORMAL LIMITS AND FROM 44 PERCENT TO 56 PERCENT ON FUNDS IN EXCESS OF THE ESTABLISHED LIMIT. THE LIMIT FOR INVESTMENT BANKS AND FINANCEIRAS CORRESPONDS TO 3 PERCENT OF TERM DEPOSITS. THE CENTRAL BANK CHARGES APPLIED TO THESE INSTITUTIONS ARE 2 PERCENTAGE POINTS LESS THAN THE ABOVE BASIC RATES IF THE CREDIT IS UTILIZED FOR LESS THAN 30 DAYS AND ARE 2 PERCENTAGE POINTS HIGHER IF THE CREDITS ARE OUTSTANDING IN EXCESS OF 90 DAYS.

4. THE CENTRAL BANK ALSO PURSUED DURING THE LAST WEEK OF JULY OPEN MARKET OPERATINS THAT WERE DESIGNED TO SOAK UP EXCESS LIQUIDITY. THE AUTHORITIES INCREASED THE YIELD ON SIX-MONTH TREASURY BILLS (LTN) FOR THE FIRST TIME SINCE JANUARY IN A MOVE TO INCREASE THE ATTRACTIVENESS OF LTN FOR INVESTORS. THE RESULT WAS A NET WITHDRAWAL OF MONEY THROUGH INCREASED SALES OF LTN.

5. THESE MOST RECENT RESTRICTIVE MEASURES WERE CONSISTENT WITH CURRENT MONETARY POLICY (REF B) AND WERE PROMPTED BY LARGE-SCALE RECOURSE TO CENTRAL BANK FUNDS BY THE BANKING SYSTEM DURING JULY. USE OF THE REDISCOUNT WINDOW BECAME ESPECIALLY PRONOUNCED AFTER THE EXTENSION OF THE STERILIZATION OF FOREIGN LOANS FROM 30 TO 120 DAYS (REF C). OUTSTANDING UNCLASSIFIED

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COMMERCIAL BANK REDISCOUNTS WERE PROJECTED AT ABOUT CR\$1 BILLION DURING JULY IN THE MONETARY BUDGET BUT IN FACT AVERAGED ABOUT CR\$7 BILLION DURING THE MONTH AND REACHED A RECORD LEVEL OF CR\$9.3 BILLION AT ONE POINT IN THE THIRD WEEK OF THE MONTH. THIS USE OF CENTRAL BANK CREDIT BECAME AN ALTERNATIVE TO UTILIZATION OF THE PROCEEDS OF FOREIGN LOANS AND PERMITTED THE COMMERCIAL BANKS TO CONTINUE THEIR LENDING WELL ABOVE MONETARY BUDGET PROJECTIONS. ALTHOUGH THE MONEY SUPPLY CONTRACTED IN THE FIRST TWO WEEKS OF JULY (CUMULATIVE CY GROWTH OF 8.4 PERCENT COMMPARED TO 12.1 PERCENT AT THE END OF JUNE), THIS WAS SEEN AS LARGELY SEASONAL AND INADEQUATE BY THE MONETARY AUTHORITIES. FURTHER EXPANSION IN THE LAST TWO WEEKS (DATA ARE NOT YET AVAILABLE) APPARENTLY CONVINCED THE AUTHORITIES OF THE NEED TO FURTHER TIGHTEN MONETARY POLICY.

6. THE REXPECTED RESULT OF THE RECENT ANNOUNCEMENTS IS A RISE IN MARKET INTEREST RATES. BOTH CENTRAL BANK PRESIDENT PAULO LIRA AND FINANCE MINISTER MARIO SIMONSEN HAVE ACKNOWLEDGED PUBLICLY

THAT SUCH A RESPONSE IS PROBABLY THE INEVITABLE  
RESULT OF THESE QUOTE NECESSARY STEPS END QUOTE.  
INVESTMENT BANKS ARE CURRENTLY PAYING AROUND 50  
PERCENT FOR TIME DEPOSITS AND CHARGING 55-57  
PERCENT FOR 180 DAY LOANS. THESE REATES COULD RISE  
FURTHER AND BEGIN TO IMPACT NEGATIVELY ON GROWTH IN  
THE INDUSTRIAL SECTOR. THE MONETARY AUTHORITIES  
CLEARLY HAVE CONTEMPLATED THAT POSSIBILITY  
AND CONCLUDED THAT THEY HAVE NO ALTERNATIVE IF THEY  
ARE TO GAIN CONTROL OVER THE UNDESIRABLY RAPID  
EXPANSION OF THE MONETARY AGGREAGES.  
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## Message Attributes

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